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December 19, 1996

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VIA HAND DELIVERY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

RE: Federal State Joint Board Universal Service
CC Docket No. 96-45
Comments of Roseville Telephone Company

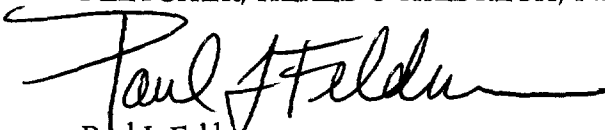
Dear Mr. Caton:

Transmitted herewith, on behalf of Roseville Telephone Company, are an original and four (4) copies of its Comments in the above-referenced proceeding.

Should any questions arise concerning this matter, please communicate directly with this office.

Very truly yours,

FLETCHER, HEALD & HILDRETH, P.L.C.



Paul J. Feldman

Counsel for Roseville Telephone Company

Enclosures

cc: Mr. Greg Gierczak (w/ encl.)
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BEFORE THE

Federal Communications Commission **RECEIVED**

WASHINGTON, D.C. 20554

DEC 19 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

Federal State Joint Board)

Universal Service)

CC Docket No. 96-45

To: The Commission

COMMENTS OF ROSEVILLE TELEPHONE COMPANY

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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

In the Matter of)	
)	
Federal State Joint Board)	CC Docket No. 96-45
Universal Service)	

COMMENTS OF ROSEVILLE TELEPHONE COMPANY

Roseville Telephone Company ("Roseville") hereby submits its comments on the Joint Board's Recommended Decision in the above captioned proceeding released November 8, 1996 (hereinafter, the "RD").

I. Introduction

The Joint Board's Recommended Decision on universal service represents an admirable and comprehensive attempt to ensure that, consistent with the intent of Congress, high quality telecommunications services remain available throughout the United States at affordable rates. Nevertheless, Roseville believes that certain sections of the Joint Board's recommendations should be modified or clarified by the Commission in order to ensure that universal service support is adequate and appropriately targeted to achieve statutory objectives, and recognizes the economic realities of telecommunications company investment patterns and revenue sources.

In particular, Roseville believes that the following aspects of the RD should be modified or clarified by the Commission:

- The contribution base for universal service support should include intrastate as well as interstate revenues.

- Funding should be provided for second residential and multi-line business lines.
- The use of proxy models to determine cost of service for the purpose of universal service support should be abandoned.
- The use of nationwide average revenue per line as a benchmark for determining the level of universal service support a company receives is inappropriate.

Although these issues do not represent an exhaustive catalog of Roseville's concerns with respect to the RD, we have chosen to focus on those aspects of the RD which are most fundamental to ensuring that the funding basis and mechanisms developed will enable and maintain the availability of universal service.

In the remainder of these comments, Roseville will address each of the issues listed above.

II. The Contribution Base For Universal Service Support Should Include Intrastate As Well As Interstate Revenues.

In its RD, the Joint Board recommends that the Commission seek comments on whether the contributions for high-cost and low-income assistance should be based on both interstate and intrastate revenues (RD at para. 822). Roseville strongly urges that both revenue sources be included in order to recognize that all customers and services, both state and interstate, benefit from universal service, and to spread the burden of universal service support as broadly, and therefore as fairly, as possible.

Universal service essentially means universal connectivity. In the context of high-cost funding, this implies that persons in all parts of the country can obtain access to telecommunications services to send or receive voice or data (e.g., fax, low speed Internet access, etc.) transmissions at affordable rates. Because universal connectivity

provides additional value to all users of telecommunications services, increased penetration creates, in an economic sense, a positive externality. The benefits of this externality, however, do not accrue solely, or generally even principally, to users of interstate services; rather, the benefits accrue to all users of telecommunications services. Consequently, spreading the burden of universal service support over all services, regardless of jurisdictional designation, will more closely match costs and benefits than an interstate-only assessment.

Although interstate revenues currently represent a significant portion of ILEC, CAP, and IXC revenues, they are a considerably lower portion of, for example, the revenues of CMRS providers. In the future, as local competition escalates, different carriers will pursue different marketing and pricing strategies which will generate a different balance of intrastate and interstate revenues. Yet all such competitors will benefit from the availability of universal connectivity, regardless of relative jurisdictional revenues.

In addition to the fact that universal service benefits all users, basing support mechanisms only on interstate revenues would burden principally the IXCs, ILECs, and CAPs, and thus would not be competitively neutral. In many cases, interstate services are a potential substitute for intrastate ones; thus burdening only interstate services distorts price/cost relationships for interstate services and results in artificially reduced consumption of interstate services.

This potential distortion would be magnified in its impact insofar as it is inconsistent with Ramsey pricing principles. Inasmuch as a universal service support

assessment, as proposed, is essentially a tax, Ramsey pricing rules are especially applicable. Ramsey's inverse elasticity rule indicates that taxes should be more heavily assessed on goods and services for which consumers are less likely to reduce their consumption in response to price increases, rather than on goods and services for which demand is more elastic. Because interstate services have typically displayed greater price elasticity than intrastate services (i.e., long-haul toll is more elastic than short-haul toll which, in turn, is more elastic than local), assessing only interstate services would be directly contrary to Ramsey pricing principles. While broadening the revenue base to include intrastate services obviously would not be a strictly Ramseyan solution, it would more closely approximate such a solution than an assessment only on interstate services.

In addition to the principles stated above, it should be noted that carriers are likely to experience a significant decrease in interstate revenues, which likely will contribute to increasing instability in the overall contribution base. This decrease likely will result from at least three factors:

- Arbitrage pressures will force interstate access rates to move towards the much lower interconnection charges mandated by the Local Competition First Report and Order (if upheld by the Eighth Circuit) and in most state interconnection agreements.
- Likely reduction of interstate access rates by the Commission, along with RBOC entry into the interLATA market, will put downward pressure on interstate retail rates.
- Competitive LECs using their own facilities or purchasing unbundled network elements will reduce incumbent LECs' interstate traffic volumes and access revenues--revenues which, depending on CLEC pricing strategies (and reflecting their incentives to avoid contribution payments) are not likely to be recovered

from CLEC interstate revenues.

The likely reduction in interstate revenues due to these factors will make interstate revenues an increasingly unstable contribution base in the future. This will complicate administration of the assessment process and ultimately may create funding shortfalls detrimental to the support of universal service. Using a broader contribution base to include intrastate revenues will avoid this outcome.

Finally, including intrastate revenues in the contribution base does not appear to be an impermissible encroachment on state ratemaking authority. The contribution charge on customers' bills could be shown as a separate and distinct federal charge--it would simply be based on both interstate and intrastate revenues. In the same manner that state and local authorities may assess taxes on interstate services billed to customers in their jurisdiction without encroaching on federal authority, the Commission can include intrastate revenues in the contribution base without encroaching on state authority.¹ Furthermore, it should be noted that the current USF mechanism is based on both the interstate and intrastate jurisdiction: USF currently utilizes the total costs of a company and is funded out of a mechanism based on presubscribed lines. As the costs and the presubscribed lines include intrastate assignment, the current USF development and reimbursement mechanism already incorporates the intrastate jurisdiction in the process.

¹ See, Goldberg v. Sweet, 488 U.S. 252 (1989) (State may impose excise tax on interstate telecommunications services originated or terminated in that State).

III. Funding Should Be Provided For Second Residential And Multi-line Business Lines.

The RD proposes that support payments should be available only for a single connection to residential and business customers, thereby eliminating support for second residential lines and multi-line business customers (RD, paras. 89-91).

Roseville asserts that restricting support in this manner would be administratively burdensome (and perhaps impossible), could improperly distort carrier costs, and significantly hamper business development in rural areas.

The Joint Board has recommended that high cost support be based on proxy costs minus a nationwide average revenue per line benchmark, with separate benchmarks developed for residential and single-line business customers. In order to construct these benchmarks, carriers must separately identify revenues from local, access, discretionary, and other appropriate services for residential and single-line business customers. Restricting support to these two customer classes poses at least two significant problems for benchmark construction.

First, requiring that multi-line business and second-line residential access traffic be separately identified would make the traffic studies necessary to create a benchmark almost impossible to conduct. In order to develop reliable revenue benchmarks, such traffic would need to be identified separately due to the likelihood that multi-line business and second-line residential customers would have significantly different toll usage levels than other business and residential customers (higher in the case of a multi-line business and lower for a second-line residential). Yet, access charges are

generally billed to interexchange carriers, not end-users. As such, LECs have no direct way of determining whether access revenue is attributable to residential (first or second line), single-line business, or multi-line business customers. This problem is exacerbated by the fact that, for most large toll users, IXCs have assumed the billing function. Consequently, LECs would not even be able to use customer toll billing records to estimate access revenues by customer class in many cases. Although special traffic studies could be conducted to develop these estimates, such studies would be costly and complex undertakings and unlikely to provide reliable and consistent results due to differences in study methodologies between carriers. Such traffic studies would be extraordinarily complex even if the only split required was between business and residential customers.

Second, similar problems would arise with respect to discretionary service revenue, such as for CLASS and customer calling services. Although many carriers charge different rates to business and residential customers for such services, thereby appropriately attributing revenue to these broad customer classes, revenues from multi-line business and second residential lines are not routinely separately identified. Again, a relatively complex and costly study of billing records would be required. Moreover, for residential customers with multiple lines who use discretionary services on one line but not the other, the company would also need to determine which line is primary and which is secondary—an impossible task.

Excluding multi-line business and second residential users would probably also distort the development of the net cost standard (proxy costs minus average revenue).

If multi-line business and second residential lines are deemed ineligible for support, the proxy model should also be adjusted to exclude the costs of serving such customers as well. If the hypothetical proxy cost network reflects the network design and sizing characteristics that would be deployed to serve all customers, the characteristics of this network would be quite different than those of one designed to serve only single-line customers, especially in areas with significant numbers of multi-line business customers. For example, carriers would be required to purchase switch software used exclusively for multi-line services (e.g., Centrex); the placement and sizing at remotes, subscriber carrier and optical nodes would likely be different; and the decision whether to deploy fiber or copper lines for feeder facilities could differ. These differences would be reflected in the proxy costs per line--relative to the network costs that would be incurred to serve only single-line customers. It is likely that this approach would understate the proxy costs per line to serve only single-line customers because of the typically lower per unit cost of delivering service on multiple lines to a single location.

Failing to match the network characteristics and costs to the services actually eligible for support is inconsistent with the economic principles underlying the proxy approach. Proxy costs are intended to reflect efficient resource deployment by an economic decision maker in a competitive market. Yet, as noted above, the most efficient network serving only single-line customers would differ considerably from that used to serve all customers. In addition, an economic decision maker would estimate the revenue impacts of their resource deployment options. These would also be quite different depending on whether all, or only single-line, services were provided. Basing

cost estimates on one set of service assumptions while developing revenue estimates on different assumptions would be irrational economic decision making. Basing proxy costs on a network that would serve all customers while only providing support to single-line customers similarly does not accurately reflect the economic choices (e.g., entry or exit) that telecommunications providers would make in a competitive market.

Finally, in the highest cost areas, failure to provide support for multi-line business services could create a significant obstacle to rural economic development. Although telecommunications costs are only one element considered by business in determining where to locate, they could become a major factor in location decisions once multi-line business rates exceeded some threshold. This would be especially true for telecommunications-intensive businesses, such as Internet service providers, telemarketers, and customer service centers, who have frequently been viewed as potential spurs to rural economic development.

IV. The Use Of Proxy Costs To Determine High Cost Support Levels Is Misguided.

Roseville is puzzled by the Joint Board's, and the Commission's, continued infatuation with proxy models, particularly in light of mounting evidence that the models are technically flawed insofar as they fail to reflect accurately the development of networks, their deployment, as well as the cost structure of small and mid-sized telephone companies. Roseville also concludes that, beyond those obvious problems with proxy models, the purported advantages of a proxy approach are illusory. Among the advantages cited for the use of proxies are:

- They allegedly better reflect how costs and prices are established in a

competitive market.

- They allegedly reflect efficient resource deployment decisions made in a competitive market.
- They allegedly reduce the ability of companies to manipulate the system to their benefit by providing appropriate economic incentives.

Unfortunately, however, none of these conditions has been shown to be true in most parts of the "real world", including the telecommunications industry.

First, one underlying tenet of the proxy approach is that proxies will equal long-run marginal cost in a competitive market. While this assumption may reasonably approximate conditions in pure commodities markets (e.g., grain markets) in which goods or services provided by different firms are perfectly fungible, the assumption fails in most markets. Because, in most markets, the goods and services provided by different firms are not perfect substitutes, prices are predicated on the value a consumer imputes to the attributes of a particular good or service. Thus, for example, the price differences between a Cadillac and a Chevrolet likely do not accurately reflect differences in manufacturing costs, as much as differences in customer perceived value. This does not, however, suggest that the automobile market is not competitive, but that, even in competitive markets, price differences frequently deviate from differences in costs. The costs reflected in the proxy models account for the provision of all services, which, with the possible exception of POTS, are generally not treated as commodities nor priced as such. Consequently, holding LECs to a long-run marginal cost standard is unlikely to reflect the economic realities of competitive telecommunications markets--exactly the reality proxy costs are intended to capture.

Second, proxy costs based on deployment of the most efficient network possible at one time, do not, and will never, reflect how networks, or productive resources in other industries, are actually constructed and expanded. Networks, like other productive resources, are deployed gradually over time in response to changing supply and demand conditions in the market. At no time, except perhaps in a start-up situation, will a company use the most efficient resources available. Rather, companies use a mixture of old and new facilities, based on ongoing evaluations of market and cost conditions. This is one reason that even unregulated companies generally measure assets at historical cost for performance evaluation. In five or ten years, it is unlikely that any LEC, competitive or incumbent, will be deploying the most efficient network possible. Network assets are too costly to be replaced very often, even if more efficient configurations could now be deployed. Network deployment is thus a dynamic, not static, process. The use of proxy costs based on the most efficient resources currently available reflects a static view--a network frozen in a moment. Embedded costs, on the other hand, more accurately reflect the dynamic and incremental nature of the resource investment decisions LECs make over time, especially as telecommunications markets become more competitive with multiple established providers.

Third, there is no evidence on the record of this proceeding, or its predecessor, CC Docket No. 80-286, that ILECs have inefficiently expended resources in order to manipulate the existing USF systems, despite the existence of incentives to increase embedded costs. A system based on proxy costs, on the other hand, creates precisely

the opposite incentive--to minimize network investment and costs. Although neither outcome is optimal, an incentive to degrade service quality by minimizing costs, will do more to harm the availability of high-quality telecommunications services in high-cost areas than the opposite incentive, especially in high-cost areas where competition, at best, will appear later rather than sooner. Use of embedded cost structures, combined with (generally already existing) state regulatory oversight of company costs will be more likely to promote access to reasonably comparable services in high-cost areas than the use of proxy costs.²

The Eighth Circuit's order staying the FCC's rules issued in CC Docket No. 96-98 explicitly recognizes that the use of proxy rates in that context was likely to cause LECs to suffer "unrecoverable economic losses," resulting in "irreparable harm." Such an outcome is equally likely in the context of providing high-cost support, and equally unlikely to comport with applicable legal standards. LECs serving high-cost areas would

² While Roseville believes that the advantages of using proxy costs are illusory, the problems are quite real. Aside from the obvious technical problems with the existing proxy models--problems well documented by other parties in this proceeding--the failure of the proxies, in most cases, to enable regulated telecommunications companies to recover the costs expended in the past to provide regulated services would appear to be confiscatory. The basis of this failure is straightforward. Proxy costs are based on a network which incorporates the most efficient technology currently available. However, due to the dynamic nature of network development over time, such a network will never exist. And, as appears to be the case, if current network technologies are more efficient than those used in the past, basing rates or high-cost support on these models costs will almost inevitably deny carriers the opportunity to recover their actual capital investment, let alone earn a fair return on that investment. By virtually any standard, this constitutes an unconstitutional taking. See FPC v. Hope Natural Gas, 320 U.S. 591 (1944); Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989).

have little opportunity, in the absence of adequate high-cost support, to recover unfunded costs from other sources. Even if such LECs do not have competition, access rates are constrained by regulatory pricing and costing rules (and are likely to decrease in the future), while the magnitude of local rate increases potentially required could exceed customers' ability or willingness to pay. As such, denying high-cost LECs the ability to recover their embedded costs will almost inevitably result in unrecoverable economic losses.

Finally, the Joint Board recognized that it is inappropriate to apply proxy models for rural carriers at this time because "the models are currently based on expense data for large LECs" (RD at para. 271). The Commission should recognize that similar considerations also apply to mid-size carriers, such as Roseville. Roseville serves slightly more than 100,000 access lines and clearly will not achieve the economies of scale and scope achievable by an RBOC or GTE. In addition, Roseville is unable to obtain the same level of discounts from equipment vendors as the large LECs. Consequently, if the Commission ultimately adopts a proxy model approach, mid-size LECs, such as Roseville, should not be subject to the model's results until the model has been modified to more accurately incorporate the cost structures of such LECs.

V. The Use Of A Nationwide Average Revenue Benchmark Will Not Reflect Unavoidable Differences In Carrier Revenue Levels.

The use of nationwide average revenues per line as a standard measure of achievable LEC revenue levels for the purposes of determining high cost support will not accommodate inevitable and unavoidable differences in the operating environments

of individual LECs. Many of the factors affecting a LEC's ability to generate revenues are, in large part, beyond its control. Among these factors are:

- Size of local calling area;
- Availability of EAS;
- Customer demographics (e.g., income levels);
- Amount of short-haul toll;
- Levels of interstate and intrastate access traffic;
- State rate-making policies;
- Receipt of toll revenue versus serving only as an access provider; and
- Inability of existing switches to provide discretionary services, such as CLASS.

Penalizing carriers with below-average revenues per line, as the use of this benchmark would, fails to recognize these unavoidable differences in operating circumstances.

This result would effectively deprive these carriers of the ability to recover all their costs.

Significant differences in revenue levels clearly exist. Based on USTA's statistics for 1994, average operating revenue per access line for the 20 largest LECs ranged from \$45 per line per month (SBC) up to \$72 (Puerto Rico Telephone). Although these figures include toll, multi-line business, USF, and private line/special access revenues--amounts that would not be included in the benchmark--they do indicate the variation in revenue levels which exist even among the largest LECs. Such differences are even greater among smaller LECs. Variations of this magnitude clearly demonstrate the inappropriateness of a "one-size-fits-all" benchmark.

Finally, there are clearly technical problems with the benchmark as proposed.

First, as discussed above, the development of separate benchmarks for single-line business and residential customers, along with the exclusion of multi-line business and second residential lines, will make it extremely difficult, if not impossible, to appropriately attribute access and discretionary service revenues to each benchmark.

In addition, the exclusion of toll revenues from the benchmark will clearly favor those companies which are designated interLATA toll providers and do not charge themselves for access over companies that are only intraLATA access providers. This inequity would occur even though both types of companies use their local networks in the same manner to originate and terminate intraLATA toll calls. Differential treatment of companies which provide the same service--intraLATA access--but record the revenues differently for accounting purposes is clearly inequitable and not competitively neutral.

VI. Eligibility to Receive Universal Service Support
Should Ensure Competitive Neutrality.

The Joint Board concluded that no eligibility criteria should be imposed on carriers receiving universal service support other than those criteria specifically listed in Section 214(e) of the Communications Act. RD at para. 156. While such criteria require eligible carriers to offer all services supported by Federal universal support mechanisms, and to advertise the availability of such services, these criteria alone are insufficient to ensure that funding is distributed on a competitively neutral basis, as required under Section 254(h)(2) of the Act, and the Commission should establish additional specific criteria for eligibility. Similarly, in order to ensure that facilities-based

carriers are not improperly deprived of support funds while resellers obtain a "double recovery" of such support, the Commission should specify certain limitations on receipt of universal service support funds by resellers of service.

Section 254(h)(2) of the Act requires that support mechanisms operate in a competitively neutral manner. Yet, the eligibility requirements set forth in Section 214(e) of the Act are general principles only, and without more specific rules from the Commission, are insufficient to prevent competitive carriers from side-stepping the costs incurred by incumbent LECs in fulfilling their obligations to be the carrier-of-last-resort. Providing USF funds to CLECs under such circumstances would be inconsistent with the principle of competitive neutrality. Accordingly, the Commission should establish other eligibility criteria, derived from Section 214(e). For example, in compliance with Section 214(e)((1)(A)'s requirement that eligible carriers provide all services support by USF, the Commission should make it explicit that the competitive carrier must provide such services in a manner meeting all federal and state performance quality and customer service standards. Similarly, the Commission should make explicit that the "media of general distribution" in which advertisements must be placed (in compliance with Section 214(e)(1)(B)) must not be limited to general business publications, but rather, must include publications targeted to the general residential market.

The Commission must also recognize that the purpose of universal service support mechanisms is ultimately to fund the costs of the facilities that provide service to high-cost or low-income subscribers. Accordingly, the Commission must ensure that

support funds are rationally distributed so that the carrier constructing and maintaining facilities used to provide service receives the support. Unfortunately, the Recommended Decision's provisions regarding distribution of funds to resellers is likely to result in incumbent carriers recovering less than the costs of providing service while resellers will receive substantially more than their cost of providing service.

A facilities-based carrier's retail rates reflect the universal service support received by that carrier, and accordingly its rates are discounted below the level that would be required to be charged if no support was received. The reseller of these services will implicitly receive this support directly through the resale rate as it will only pay the resale rate, which is discounted from the retail rate. It would not be competitively neutral to allow the reseller to receive this implicit support, and then receive additional support directly from a universal service fund. The result of this is that the reseller ends up receiving double compensation of universal service support. At the same time, because the facilities-based carrier is losing the direct contribution, while selling the service for less than its cost, the facilities-based carrier ends up receiving substantially less than its cost of providing service. This result is not only inconsistent with competitive neutrality, but also irrationally fails to target support to the party paying for the full cost of the facilities. Accordingly, pure resellers of local service should not be eligible to receive universal support funds, and carriers that use a combination of their own facilities and resale should be eligible for support only for the portion of services provided through their own facilities.

VII. Conclusion

Adopting the modifications and clarifications to the Joint Board's RD proposed by Roseville will ensure that future mechanisms for universal service support are sustainable, administratively workable, and reflect the actual characteristics of LECs' operating environments. Consequently, Roseville strongly recommends that the Commission incorporate its proposed changes in the final version of the universal service support system.

Respectfully submitted,

ROSEVILLE TELEPHONE COMPANY

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December 19, 1996

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I, Deborah N. Lunt, a secretary in the law firm of Fletcher, Heald & Hildreth, P.L.C., do hereby certify that true copies of the foregoing "Comments of the Arkansas Broadcasters Association" were sent this 19th day of December, 1996, by first class United States mail, postage prepaid, to the following:

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